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Supreme Court of the United States

OCTOBER TERM, 1935

No. 26

GEORGE W. McCANDLESS, as Receiver of DUQUESNE GAS CORPORATION,

Petitioner,

vs.

MAXIME H. FURLAUD, KINGSTON CORPORATION, BYRON CORPORATION, *et al.*

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

PETITIONER'S REPLY BRIEF

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At page 2 respondents make a misleading statement. They say:

> "Kingston Corporation had at great expense acquired options on various properties upon which it had paid various sums of money (R. 51-52). These options were acquired in the latter part of 1929 and the early part of 1930."

In fact, the options when originally taken in the latter part of 1929 and in the early part of 1930 were mere gratuitous options (Pls. Exs. 2-10, R. 164-170). Later in anticipation of the general closing set for April 9, 1930 and so as to make the options enforceable, some comparatively small sums were paid to the optionors aggregating a total of $45,510 (R. 53-54, 170A). Pages 51 and 52 of the Record

which are referred to by the respondents show the purchase prices of the various properties. The above quoted statement of the respondents is phrased in such a way as to carry the suggestion that these large sums mentioned on pages 51 and 52 constitute the "great expense" of acquiring the options.

At pages 4 and 5 and again at pages 24-26, the respondents set out repetitiously a long quotation from the opinion of Judge Knox at pages 222 and 223 of the Record in an effort to make it appear that Judge Knox found that all of the securities of the Duquesne Gas Corporation belonged to the respondents at the time of the closing. We call the Court's attention to the fact that in each instance the respondents have deleted from this quotation the following which appears in Judge Knox's opinion at page 223:

> "Throughout the proceedings, representatives of the various security dealers who were to distribute the bonds to the public were waiting without the room in which the foregoing transactions were being consummated. They carried checks for the purchase price of the bonds which their firms had respectively undertaken to distribute. These checks totaled about $3,000,000 and they were immediately exchanged for about eighty percentum of the whole bond issue. When this had been accomplished, Furlaud & Company, Inc. out of the money so obtained, and with that which had come from Kingston Corporation, liquidated the credit which it had obtained from the Trust Company."

At page 6 of the Respondents' brief, the following appears:

> "The Court of Appeals recited the facts of the transaction between Duquesne Gas Corporation in

almost the identical language employed by the lower Court (R. 263-267). It then quoted the following from the opinion of the Trial Court: (R. 388-389)

> 'At the time that the transaction through which Duquesne Gas Corporation acquired the various gas properties were consummated, and for some time thereafter, Furlaud & Company, Inc. owned every share of its capital stock, and ratified and approved of the whole transaction.'

"Then follows the language complained of by the petitioner:

> 'At the end of these transactions, the two corporations, Furlaud & Company, Inc. and its subsidiary, Kingston Corporation, owned all of the issued common capital stock of the Duquesne Gas Corporation, and all of its bonds and notes. No other person purchased from Duquesne Gas Corporation a share of stock, a bond or a note' (R. 268).

"There is no question about the actual facts in this case.

"They are correctly stated by the Trial Court and by the Court of Appeals."

Read hastily in the foregoing context, the quotations from the opinions of the District Court and the Court of Appeals may seem much alike. *But they are vitally different.* The quoted part of the District Court's opinion is limited to the *capital stock,* while the opinion of the Circuit Court of Appeals goes further and says that the respondents "owned all of the issued common capital stock of the Duquesne Gas Corporation, *and all of its bonds and notes.*"

It is misleading to say that the two courts viewed the facts alike and used almost identical language. As shown by the above quoted part of Judge Knox's opinion which

the respondents deleted, the Trial Court's view of the facts was that a very large amount of bonds were paid for at the closing of the transaction between the promoters and the corporation by innocent bondholders and the bonds then issued to them, and that the moneys of these bondholders were used to pay for the properties upon which the promoters made their secret profit.

The respondents, themselves, virtually admit at pages 7-8 of their brief that a very large amount of the bonds were at the time of closing sold to various innocent purchasers and the proceeds used in payment for the property. At this point the most that they claim is that the amount thus received from innocent bondholders was only $1,886,330, or substantially less than the amount found by the Trial Court.

It is indisputable that these bonds were not issuable to anyone until the deeds to the corporation were delivered by the sellers and the mortgage securing the bonds recorded,—all of which occurred on April 9th, 1930 as a part of a simultaneous closing of the transaction between the promoters and the corporation, as a part of which closing the bank messengers from the various purchasers of the bonds made delivery of their certified checks against definitive delivery to them of the bonds. The statement, therefore, in the opinion of the Court of Appeals and in the respondents' brief that at the time of the closing of the transaction respondents "owned all of the issued common capital stock of the Duquesne Gas Corporation, *and all of its bonds and notes*" is a misstatement of a vital fact.

Respondents in Points I and II of their brief, pages 13-23, argue that the complaint is insufficient and that

there was a variance between the allegations and the proof, and, in this connection, that certain testimony was erroneously admitted. Their contention seems to come to this: that the complaint is to be viewed as an attempt to state a cause of action for misrepresentation and that it is insufficient, in that it does not allege that the misrepresentations were false or the other essentials of a cause of action for misrepresentation. This contention is reasserted at several other places throughout the brief. Respondents' effort to sustain the judgment of the Court of Appeals seems to be based chiefly upon this.

It is clear from the opinions below that both of the lower courts regarded the complaint as stating a good cause of action in equity for an accounting, and we submit that as to this the courts below were right.

The eighth paragraph of the complaint (R. 6-7) alleges the issuance of the bond and note circulars and refers to them in such a way as to show that a fiduciary relationship to the corporation arose from the statements in the circulars, making the defendants accountable to the corporation for the proceeds of the bonds and notes. The fiduciary relationship of the defendants to the corporation is also well alleged in the fourteenth paragraph (R. 9) as also arising from the fact that the defendants "Furlaud and Reuter were the promoters of said Duquesne Gas Corporation; that they caused it to be organized; that all the steps which were taken for the consummation of its incorporation, organization, issuance of its said bonds, notes and stocks were taken under the direction and at the behest of defendants Furlaud and Reuter; that they stand in a fiduciary relation to said Duquesne Gas Corporation; that defendants Furlaud and Reuter are accountable to the corporation for the proceeds derived from the issuance and sale by them as aforesaid of all of said securities of said

"corporation." The prayer for relief is full and in proper form as a prayer for relief for an accounting (R. 13).

The respondents merely treat the complaint as something of a nature entirely different from what it is in order to attempt to construct some argument in respect to it.

As to the contention respecting the admission of testimony, that is without the least merit. Their criticism along this line is rather general. The alleged errors are not clearly specified.

The bond and note circulars (prospectuses) and advertisements were put in evidence by the plaintiff (Pls. Exhs. 22, 23, 24, 25, R. 180-197). These prospectuses set forth a valuation of $7,039,000 for the corporate property, including working capital of $365,000. Plaintiff also proved that the cost of the property, excluding working capital, was $2,572,989 (R. 170A). The respondents do no seem to base their criticism upon the admission of the foregoing testimony.

The Trial Court brought out some evidence relating to the value of the property (R. 60) and the plaintiff proved facts showing the outrageous character of the respondents' steps in obtaining the fraudulent appraisal of part of the property, the facts as to which are sufficiently related at pages 219 and 220 of the opinion of the Trial Court. This seems to be what the respondents are now protesting about. As to the admission of evidence as to the value of the property, which the respondents seem to stress as the main error, it is entirely comprised of a statement of the witness Nuss in answer to questions by the Trial Court that his property was worth about what the corporation paid for it, viz.: $660,000, although it was included in the fraudulent appraisal at $2,500,000 (R. 16). Since the respondents were willing purchasers of the gas properties, which under their

scheme were to be paid for with other people's money, the selling price was presumably as much as the owners could get and all that the property was fairly worth. Whether the property was worth something more or less than it cost, the fact remains that these respondents, who stood in a fiduciary relation to the corporation, used it as a means of extracting the secret profit for which they should be held accountable. In any view of it, we submit that the facts relating to the proceedings of these fiduciaries in consummating their fraudulent scheme were manifestly relevant to the case and very material.

Respondents (pp. 31-38 of their brief) seem to agree that this Court's *Old Dominion* v. *Lewisohn* and *Davis* v. *Las Ovas* decisions, when read together, establish that it is enough to make promoters accountable to the corporation for a secret profit if other parties then interested in the corporation did not share in the profit and were without knowledge of it. They simply claim the fact to be that at the time of the closing of the transaction between the promoters and the corporation there was no one interested in the corporation excepting themselves. The plain fact of the matter is, however, that bondholders, without knowledge of the secret profit became interested parties at the moment of the closing and as a part of the closing transaction, and that their moneys were used to pay for the property out of which the secret profit was derived. Since the fraudulent misappropriations made by the respondents rendered the corporation insolvent at its start, the corporation and its creditors were grievously wronged. Upon such a state of facts and upon the respondents' own view of

the law, they are accountable to the plaintiff for the whole secret profit.

As Point IX of their brief, pages 55-57, respondents suggest that this Court fell into error in making its previous decision in this case, 79 L. Ed. 32. They neglect to call the Court's attention to the fact that they filed a petition for rehearing which was denied (79 L. Ed. 198). Respondents refer to this Court's decision in *Mitchell* v. *Maurer*, 79 L. Ed. 149. But it would seem that the respondents have not read very carefully *Mitchell* v. *Maurer*. This Court in the body of its opinion refers to its decision just then handed down in *McCandless* v. *Furlaud* and again refers to it in two separate footnotes. In one of the footnotes (numbered 4), the Court points out that:

> "The order appointing ancillary receivers attacked in *McCandless* v. *Furlaud* * * *, on the ground that the Court was without federal jurisdiction, had been entered, not in the suit there under review, but in a separate proceeding in the same court."

Another difference between the two cases is that, while in the instant case the primary receiver was appointed in the Federal Court, the primary receiver in the *Mitchell* v. *Maurer* case was appointed by a State Court.

CONCLUSION

The judgment of the United States Circuit Court of Appeals for the Second Circuit, filed March 11, 1935, should be reversed and the decree of the United States Dis-

trict Court for the Southern District of New York, filed the 11th day of May, 1933, should be modified by increasing the amount of the judgment against the defendants Furlaud and Kingston Corporation by the sum of $850,000 with interest and by awarding judgment against the defendant Byron Corporation for $425,000 with interest and against the defendant Chaucer Corporation for $425,000 with interest and the decree of the District Court as so modified should be affirmed.

Respectfully submitted,

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